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SUBJECT: EDRC REVIEW OF YUGOSLAV ECONOMY, APRIL 10

REF: EDR(74)8

1. SUMMARY: DRAFT SURVEY (REFDOC) WELCOMES SHIFT IN YUGOSLAV POLICY TO MORE EXPANSIONARY STANCE, BUT CAUTIOUS BALANCE PAYMENTS COULD AGAIN BECOME RESTRAINING FACTOR IF GROWTH RATE BECOMES TOO EXUBERANT. RATE INFLATION EXPECTED CONTINUE HIGH. END SUMMARY.

2. DRAFT SURVEY (REFDOC) FOCUSES ON TWO PRINCIPLE TOPICS: (1) RECENT DEVELOPMENTS AND POLICIES, INCLUDING DEMAND AND OUTPUT, MONETARY EXPANSION, PERSISTENT INFLATION, AND CHANGING POLICIES. (2) THE BANKING SYSTEM AND MONETARY POLICY, INCLUDING THE REFORM OF THE BANKING SYSTEM AND THE REGULATION OF THE MONEY SUPPLY.

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3. DRAFT SURVEY NOTES YUGOSLAV ECONOMY IN 1973 WAS

CHARACTERIZED BY SLOW GROWTH OUTPUT AND RAPID INFLATION, ACCOMPANIED BY CONTINUING STRENGTH FOREIGN ACCOUNT. SECRETARIAT STATES REORIENTATION OF POLICY DURING 1973 WAS WELL ADVISED AND QUESTIONS WHETHER STABILIZATION MEASURES OF LATE 1972 AND EARLY 1973 NEED HAVE BEEN SO SEVERE, PARTICULARLY IN FACE WEAK AGGREGATE DEMAND. IT NOTES YUGOSLAV ECONOMIC GROWTH IS MUCH MORE SENSITIVE TO RESTRICTIVE DEMAND MEASURES THAN IS RATE INFLATION, AND SUGGESTS BETTER ANTI-INFLATION POLICY WOULD HAVE BEEN TO LET FOREIGN BALANCE ABSORB MORE DEMAND BY AVOIDING DEVALUATION IN FEBRUARY 1973 AND SUBSEQUENT DEPRECIATION.

4. DRAFT SURVEY STATES EXPANSIONIST TREND IN POLICY WILL UNLIKELY AFFECT GREATLY RATE INFLATION - WHICH WILL REMAIN HIGH - AS LONG AS EXCESSIVE PRESSURES ON SUPPLIES ARE AVOIDED. CURRENT INCREASE IN LEVEL DEMAND PROBABLY MEANS NON-AGRICULTURAL GROWTH RATE AT LEAST 6-7 PERCENT IN 1974. BALANCE PAYMENTS COULD AGAIN BECOME RESTRAINING FACTOR IN VIEW HIGHER OIL PRICES AND POORER PROSPECTS FOR TOURISM, EXPORTS, AND REMITTANCES. HOWEVER LARGER RESERVES AND IMPROVED ACCESS TO LONG-TERM FOREIGN CAPITAL SHOULD ENABLE FASTER EXPANSION DOMESTIC DEMAND THAN IN 1973. SECRETARIAT SURVEY SUGGESTS SELECTIVE MEASURES TO COMBAT INFLATION WOULD BE DESIRABLE; I.E., REDUCTION TARIFFS AND APPROPRIATE USE OF "INTERVENTION" IMPORTS, ESPECIALLY FOOD. PRICE CONTROLS SHOULD BE USED WITH CAUTION SO AS NOT TO DISCOURAGE OR DISTORT AGRICULTURAL PRODUCTION. MAJOR GOAL SHOULD BE AVOID OVER-RAPID EXPANSION, AND 1974 POLICY TARGET CONTAINING INFLATION AT 1973 LEVEL WILL BE DIFFICULT BUT NOT OUT OF QUESTION.

5. DRAFT REVIEW SUGGESTS, AMONG OTHER THINGS, AN EARLY DECISION TO ESTABLISH A CLEAR RATIONALE FOR GUIDING INVESTMENT EXPENDITURES. IT ALSO STRESSES THERE IS AN URGENT NEED FOR A MORE EFFECTIVE MONETARY POLICY.

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6. REFDON WAS AIRPOUCHED BELGRADE AND STATE (EUR/RPE) MARCH 28. MISSION WELCOMES PARTICIPATION BY EMBASSY BELGRADE IN OECD ANNUAL REVIEW, APRIL 10. BROWN

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